Calendar No. 872

100TH CONGRESS *2d Session*	SENATE	REPORT 100-456

NATIONAL COMMISSION ON THE THRIFT INDUSTRY

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

TO ACCOMPANY

S. 2653

AUGUST 5, 1988.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1988

19-010

S243-5

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WILLIAM PROXMIRE, Wisconsin, *Chairman*

ALAN CRANSTON, California
DONALD W. RIEGLE, JR., Michigan
PAUL S. SARBANES, Maryland
CHRISTOPHER J. DODD, Connecticut
ALAN J. DIXON, Illinois
JIM SASSER, Tennessee
TERRY SANFORD, North Carolina
RICHARD SHELBY, Alabama
BOB GRAHAM, Florida
TIMOTHY E. WIRTH, Colorado

JAKE GARN, Utah
JOHN HEINZ, Pennsylvania
WILLIAM L. ARMSTRONG, Colorado
ALPHONSE M. D'AMATO, New York
CHIC HECHT, Nevada
PHIL GRAMM, Texas
CHRISTOPHER S. BOND, Missouri
JOHN H. KARNES, Nebraska

KENNETH A. MCLEAN, *Staff Director*
LAMAR SMITH, *Republican Staff Director*
RICHARD S. CARNELL, *Counsel*

CONTENTS

	Page
Introduction	1
Background of the legislation	1
Purpose of the legislation	3
Description of the legislation	3
Regulatory impact statement	4
Changes in existing law	4
Cost of legislation	4

Calendar No. 872

100TH CONGRESS
2d Session

SENATE

REPORT
100-456

NATIONAL COMMISSION ON THE THRIFT INDUSTRY

AUGUST 5, 1988.—Ordered to be printed

Mr. PROXMIRE, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

[To accompany S. 2653]

INTRODUCTION

On July 27, 1988, the Committee on Banking, Housing, and Urban Affairs (the "Committee") marked up and ordered to be reported a bill (S. 2653) to establish a National Commission of the Thrift Industry (the "Commission"). The Committee vote was unanimous to adopt the bill and report it to the Senate for consideration.

BACKGROUND OF THE LEGISLATION

The nation's thrift industry and its insurer, the Federal Savings and Loan Insurance Corporation (the "FSLIC"), are currently in precarious financial condition. As of December 31, 1987, there were a total of 3,147 FSLIC-insured savings and loans nationwide, holding deposits of $933 billion and assets of $1.25 trillion. Two-thirds of the thrift industry is sound and profitable, earning $6.6 billion in total in 1987. However, the remaining one-third accounted for losses of $13.4 billion in 1987, putting the industry as a whole in a net loss position of $6.8 billion for 1987.

A number of factors appear to have contributed to the deteriorating financial condition of the thrift industry. Beginning in the late 1970s, the thrifts experienced an outflow of deposits into higher-yielding money market investments. In 1980, Congress responded by deregulating interest rate paid on the thrifts' deposits. However, the thrifts subsequently found themselves with declining or negative interest-rate spreads between the new floating interest rates

paid on their deposits and the fixed rates received on their portfolios of lower yielding long-term mortgages.

In 1982, attempting to increase the thrifts' earnings potential, Congress permitted some modest deregulation of the asset side of Federal thrifts' balance sheets, authorizing them to engage to a limited extent in commercial lending. More significantly, many state authorities began to permit state-chartered, FSLIC-insured thrifts to diversify into a wide range of non-traditional, riskier assets, including aggressive real estate ventures. These new activities were authorized without an increase in regulatory oversight.

The rapid growth of many thrift institutions without appropriate internal controls and regulation, improper investments, overly expansive state laws, and the collapse of real estate values in the energy-dependent areas of the Southwest, coming on top of the interest-rate spread problems of the late 1970s and early 1980s, all contributed to massive losses in the thrift industry. These losses have resulted in unprecedented insolvencies as well as enormous payouts by the FSLIC. The magnitude of the required payouts has forced the FSLIC itself into insolvency.

According to the General Accounting Office (the "GAO"), the FSLIC was in a deficit position of $13.7 billion on December 31, 1987. Moreover, the FSLIC's year-end financial statements show a liability of $17.4 billion for losses on more than 260 unresolved thrift cases. However, this does not include the cost of resolving the problems of more than 250 additional thrifts which have positive net worth according to regulatory standards but have a negative net worth under generally accepted accounting principles.

Indeed, there is a large debate as to the FSLIC's exposure in these 250 additional cases. The FSLIC estimates that resolving these cases will cost $5.3 billion. However, the GAO estimates the cost to be up to $19 billion. In total, the FSLIC estimates its loss for unresolved cases to be $30.9 billion, while the GAO estimates them at up to $36.4 billion. Some analysts place the FSLIC's liabilities at over $75 billion.

There are currently over 500 GAAP-insolvent thrifts in operation nationwide. Every day they remain open increases the cost of the eventual solution to the FSLIC. As long as the so-called special assessment remains in place, the FSLIC estimates it will have sufficient resources to arrange solutions for the institutions in its case load. However, some observers believe the FSLIC may be far short of the resources necessary to resolve the case load of insolvent thrifts. Even with recapitalization through the Financing Corporation (the "FICO") provide for under the Competitive Equality Banking Act of 1987 ("CEBA"), the FSLIC may not have sufficient income to meet its liabilities. Indeed, some industry observers estimate the FSLIC net shortfall to range between $10 billion and $35 billion on problems which currently are known to exist.

The commitment made by Congress in CEBA that the U.S. Government stands behind the FSLIC underlines the serious nature of the problem. The accelerating instability in the thrift industry threatens public confidence in the financial system. Moreover, the high rates being paid by insolvent thrifts to attract deposits are forcing healthy thrifts and commercial banks to pay higher rates to remain competitive, eroding the profitablity of these institutions.

PURPOSE OF THE LEGISLATION

The rapidly worsening financial condition of the thrift industry and the FSLIC, the broad range of estimates as to the FSLIC's liabilities and fiscal shortfall, the position of the thrift industry as the nation's primary source of home mortgage credit, and the commitment of the U.S. Government to stand behind the FSLIC, may require that Congress take well-considered but expeditious action to assist the FSLIC and the thrift industry. Consequently, the Committee proposed that Congress establish a Commission to review and evaluate the condition of the thrift industry and the FSLIC, and to recommend appropriate action by Congress to return the thrift industry and the FSLIC to permanent solvency. The Commission is required under S. 2653 to submit a report to Congress by March 15, 1989, so that the Committee can begin work early in the year on a comprehensive legislative solution.

DESCRIPTION OF THE LEGISLATION

The Commission to be established by S. 2653 will comprise 14 members: 2 will be appointed by the President, 3 by the President pro tempore of the Senate upon recommendation of the Majority Leader of the Senate, 2 by the President pro tempore of the Senate upon recommendation of the Minority Leader of the Senate, 3 by the Speaker of the House of Representatives, and 2 by the Minority Leader of the House of Representatives. (These appointments will be made by October 1, 1988). In Addition, 2 appointments will be made by the President-elect in December 1988.

The Commission will be composed of experts in the field, including thrift industry leaders, academicians, prominent authorities on housing concerns, other individuals with distinctive qualifications, and members of Congress. It is the Committee's intent that the members of the Commission have diverse viewpoints and backgrounds, but all be knowledgable in the subject matter.

The Commission shall conduct an investigation and evaluation of, and shall report and make recommendations on, a number of specific issues. The Commission shall study the current and future financial condition of the FSLIC and the agency's future ability to eliminate the inventory of troubled thrifts. The Committee expects that the Commission will make the best possible estimate of the cost of resolving the FSLIC's problem cases. Moreover, the Commission will evaluate the managerial capability of the FSLIC to accomplish the task within a short period of time.

Should the Commission determine that the current financial resources of the FSLIC will be insufficient to eliminate the inventory of troubled thrifts, the Commission will make recommendations about other sources of funds.

Also to be studied are a variety of regulatory issues and reforms. Primary among them are problems in the structure of the deposit insurance system, for example, whether there should be a risk-based premium, whether the FSLIC should insure the deposits of state-chartered thrifts whose powers exceed those permissible for federal savings and loans, as well as so-called "brokered" deposits. Regulatory change such as a shift to mark-to-market accounting,

and a limitation on risky investments and excessive asset growth, should be explored.

The Commission shall also consider options for restructuring the thrift industry, including but not limited to, a merger of the various deposits thrift insurance funds and regulatory agencies, and a separation of the insurance and regulatory functions of the Federal Home Loan Bank Board.

The Commission shall also consider methods for increasing capital in the thrift industry, for example, permitting bank holding companies to acquire healthy savings and loans, and whether capital currently supplied by private investor acquirors of failing thrifts is adequate. The ability of, and the need for, the thrift industry to continue to serve as the nation's primary source of home mortgage credit shall also be evaluated by the Commission. In addition, the Commission shall consider whether and under what conditions thrifts shall be permitted to leave the FSLIC or to become banks.

It is the Committee's intent that the Commission clearly have the discretion to explore areas beyond those suggested in this Report should it determine that the exploration of other areas is necessary to meet the goals set by Congress for the Commission.

REGULATORY IMPACT STATEMENT

The Commission has evaluated the regulatory impact of the legislation pursuant to rule XXVI, paragraph 11(b) of the Standing Rules of the Senate, and concludes that the legislation would not appreciably increase the regulatory burden imposed by the Government.

CHANGES IN EXISTING LAW

The Committee has determined that it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of rule XXVI, paragraph 12 of the Standing Rules of the Senate.

COST OF LEGISLATION

Pursuant to section 403(a) of the Congressional Budget Act of 1974, the Committee has requested the Congressional Budget Office to estimate the cost of carrying out the legislation. That estimate appears below:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, August, 1, 1988.

Hon. WILLIAM V. PROXMIRE,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed S. 2653, a bill to establish a National Commission on the Thrift Industry, as ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs on July 27, 1988. We expect that enactment of this bill would cost the Federal Government approximately $500,000 in fiscal year 1989.

S. 2653 would create a 14-member commission to examine the financial condition of the Federal Savings and Loan Insurance Corporation and to propose recommendations for reform of the thrift industry. The commission would issue its report to the Congress by March 15, 1989. The bill would allow the commission to request assistance, including staffing and facilities, from federal agencies. S. 2653 would also authorize the appropriation of $500,000 for consultants and other expenses. Assuming that the commission begins its work by October 1, 1988, as required by the bill, and that the necessary amounts are appropriated, the cost to the Federal Government would be approximately $500,000 in 1989.

No costs would be incurred by State or local governments as a result of enactment of this bill.

If you wish further details on this estimate, we would be pleased to provide them. The CBO staff contact is May Maginniss, who can be reached at 226–2860.

Sincerely,

JAMES L. BLUM,
Acting Director.

○